Entrepreneurs’ relief: personal company rules, dilution provisions and dilution on the day of sale

OMB

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The CIOT wants to ascertain whether a change in HMRC’s view about dilutions of shareholdings on the day of sale (which may prevent entrepreneurs’ relief being available in certain circumstances) creates a problem; and if so, how big a problem it creates. Have you come across this in practice? We are asking members to contact us with their views.

FA 2019 introduced changes to the definition of an individual’s ‘personal company’ for the purposes of determining the availability of entrepreneurs’ relief on a disposal of shares in that company. There are additional requirements that must be satisfied for disposals made on or after 29 October 2018 which look at whether the individual shareholder has a sufficient economic interest in the company (TCGA 1992 ss 169S(3), (3A)and (3B) as substituted by FA 2019 Sch 16 para 2).
Before the FA 2019 changes, it was HMRC’s view that dilution of an individual’s shareholding by the exercise of options, or another share transaction, on the day of sale, which resulted in the shareholder owning less than 5% of the ordinary share capital, did not prevent entrepreneurs’ relief being available. See CIOT Notice ‘Entrepreneurs’ Relief – Practical points’ (example A7) (https://tinyurl.com/wyah7e5).

Following the FA 2019 changes, HMRC have changed their interpretation, as has been confirmed by their correspondence with the Institute of Chartered Accountants in England and Wales (see TAXguide 04/19 Example A5).

HMRC have also updated their guidance at CG63975, which now says: ‘Up until 28 October 2018, Condition A would not be failed where another share transaction takes place earlier on the same day as the disposal which results in the 5%

shareholding requirement not being met at the time of the disposal. From 29 October 2018, Condition A would be failed in those circumstances if the individual did not meet the economic interest requirement – see CG64051.'

Therefore, HMRC will no longer ignore share transactions earlier on the day of disposal; this is notwithstanding that the wording of Condition A in TCGA 1992 s 169I(6) has not changed. Condition A requires that, inter alia, the company is the individual's personal company (as defined by s 169S(6)) throughout the period of two years ending with the date of the disposal.

Since the wording of Condition A has not changed and this is the only time reference in the legislation, there may be doubts about whether there is any legislative basis for HMRC's change of interpretation, and indeed whether their interpretation is actually correct. We would be interested to hear readers' views on this.

A consequence of HMRC's revised interpretation is that it risks preventing genuine 'entrepreneurs' who have owned more than 5% of the ordinary shares for many years from obtaining entrepreneurs' relief on their disposal if their shareholding is diluted on the date of sale.

The individual whose shareholding is diluted may be able to elect to crystallise entrepreneurs' relief on the day of the sale using the new 'anti-dilution election', which allows relief on gains made before the individual's shareholding is diluted below the 5% threshold (TCGA 1992 ss 169SB–169SH (Pt 5 Ch 3A) inserted by FA 2019 Sch 16 para 3) but only if it is done in qualifying circumstances. There are conditions that the shares are issued for monetary consideration and are subscribed and issued for genuine commercial reasons, and not as part of arrangements to secure a tax advantage. HMRC's guidance at CG4053 states that HMRC consider that the anti-avoidance rule would not normally apply where a tax advantage arises solely through the operation of an 'approved employee share scheme' but clearly, this would depend on the facts and circumstances of each specific case.

The CIOT would like to understand what issues HMRC's change of interpretation on date of sale dilutions is creating for taxpayers in practice and how widespread these are. Have members made anti-dilution elections in such cases and have they been accepted by HMRC? We are interested to hear from members who have encountered this in practice. Please respond to technical@ciot.org.uk.